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ILLINOIS-AMERICAN WATER COMPANY)
)
Proposed general increase in water and)
wastewater rates)

02-0690

**INITIAL BRIEF AND ARGUMENT OF THE INTERVENOR
VILLAGE OF BOLINGBROOK**

NOW COMES the Intervenor Village of Bolingbrook, Will and DuPage Counties, Illinois, by its attorneys, Moss and Bloomberg, Ltd., and, as its Initial Brief and Argument in this proceeding, states as follows:

I.

Background

The Village of Bolingbrook ("Bolingbrook") is located in northern Will County. Over the past 15 years, Bolingbrook has experienced growth at a tremendous rate. Its population has increased from 39,000 to 61,000, making it the 17th largest municipality in Illinois. Since 1986, over 6600 new homes have been built and over 19,000 jobs have been created in the Village. Bolingbrook has successfully implemented a strategy to encourage a mixture of commercial, industrial and residential development within its boundaries.

Until recently, water and wastewater services were provided to one part of Bolingbrook by Citizens Utilities Company of Illinois ("CUCI") and to another part of the Village by Bolingbrook itself. The water supply was drawn from shallow aquifer wells by both CUCI and Bolingbrook. In 1995, CUCI approached Bolingbrook with a proposal for a pipeline, which would supply Lake Michigan water to the entire Village. The parties engaged in lengthy negotiations with respect to the impact that Lake Michigan water would have on their respective utility systems. After many

months of negotiations, CUCI and Bolingbrook entered into an Asset Purchase and Exchange Agreement (the "Asset Exchange Agreement"), which the Village approved as its Ordinance No. 96-120. *See*, Bolingbrook Exhibit 1.1.

The Asset Exchange Agreement was one component of an overall transaction whereby Citizens Water Resources Company ("CWRC") would build a pipeline to supply Lake Michigan water to Bolingbrook and to other communities. Once the pipeline was completed, and Lake Michigan water was being provided to Bolingbrook customers, CUCI and the Village would then exchange utility assets as provided in the Agreement.

Under the Asset Exchange Agreement, the Village agreed to convey its water utility plant to CUCI in exchange for certain cash payments, which are detailed in the Agreement, and also for CUCI's wastewater treatment plants located in the Village. *See*, Bolingbrook Exhibit 1.0 at p. 2. The closing of the Asset Exchange Agreement, however, was expressly contingent upon CUCI first delivering Lake Michigan water to the Village. *See*, Bolingbrook Exhibit 1.1 at Section 6.1 (p. 24 of the Asset Exchange Agreement).

In Docket Nos. 96-0200/96-0240 Consolidated, CWRC and CUCI jointly applied for Commerce Commission approval for a certificate of public convenience and necessity to supply Lake Michigan water through the proposed pipeline and further requested the establishment of a tariff which would set the method for calculating the customer water supply charge. Lake Michigan water began flowing to the Village on or about March 8, 2001 through the pipeline. The water supply charges were documented in Citizens Utilities Company of Illinois water tariffs (Illinois Commerce Commission No. 4, 12th revised, Sheets 41 through 44.6).

With the delivery of Lake Michigan water to the Village, one of the last conditions precedent to the closing of the Asset Exchange Agreement was satisfied. However, before Bolingbrook and CUCI had the opportunity to prepare for closing, Citizens Utilities Company (CUCI's parent corporation) decided to sell its water and wastewater assets. Among those assets were CUCI's water and wastewater assets, including the Asset Exchange Agreement.

On June 30, 2000, in Docket No. 00-0476, Illinois-American Water Company ("IAWC"), CUCI and Citizens Lake Water Company ("CLW," formerly known as CWRC) jointly filed an application with the Illinois Commerce Commission seeking approval of the purchase of CUCI's water and wastewater assets. On May 15, 2001, the Commission approved the acquisition of CUCI assets and the assumption of certain CLW agreements by IAWC. Subsequently, in Docket No. 01-0556, the Commission approved a methodology, which was to be used in IAWC's next rate case, to determine the savings, if any, attributable to IAWC's acquisition of CUCI. Any proper acquisition savings would be divided on a 50/50 basis between ratepayers and IAWC.

Finally, on January 2, 2001, in Docket No. 01-0001, IAWC applied for a certificate of public convenience and necessity to provide water service to all of Bolingbrook. Previously, CUCI's certificated water service area was limited to only a portion of Bolingbrook. Bolingbrook supported the petition. The Commission was further advised of the pending closing of the Asset Exchange Agreement, whereby IAWC, the purchaser of CUCI's assets, would acquire the Bolingbrook water system assets in exchange for CUCI's wastewater treatment plants in the Village and certain financial considerations. The Commission entered its order in Docket No. 01-0001 on April 10, 2002.

On July 25, 2002, IAWC and Bolingbrook closed on the Asset Exchange Agreement. As a consequence of the closing of the Asset Exchange Agreement and the various Commission orders approving the acquisition of CUCI's assets by IAWC, Lake Michigan water is now supplied to all areas of Bolingbrook by IAWC. IAWC further owns and operates a wastewater collection system in a portion of the Village. Bolingbrook provides wastewater collection for the remainder of the Village and provides wastewater treatment services for all of Bolingbrook's residents. Bolingbrook is now included as part of IAWC's "Chicago Metro Division."

In the present rate-making proceeding, IAWC has proposed a rate increase of approximately 64%¹ for the Chicago Metro Water ("CMW") District and a rate increase of approximately 35% for the Chicago Metro Sewer ("CMS") District. *See*, Company Exhibit 12.0, Schedule C-1, pp. 8 and 9. IAWC has proposed that its rate increase be applied across-the-board to all rate blocks. Bolingbrook intervened in the proceeding, fully participated in the hearings and has submitted testimony with respect to certain issues before the Commission. Bolingbrook's testimony relates primarily to Section 5.3 of the Asset Exchange Agreement and its effect on IAWC's pro forma rate base for the CMW District.

II.

Section 5.3. of the Asset Exchange Agreement Limits IAWC's Rate Base Increase

One of the major contested issues between Bolingbrook and IAWC involves the proper interpretation of Section 5.3 of the Asset Exchange Agreement. As previously noted, the Asset Exchange Agreement was an agreement between Bolingbrook and CUCI whereby Bolingbrook

¹The proposed water rate increase excludes any change to the Lake Michigan water supply charge, which is set by separate tariff, as discussed above.

agreed to transfer its water utility assets to CUCI in exchange for CUCI's wastewater treatment plants and other considerations. *See*, Testimony of Michael J. Drey; Bolingbrook Exhibits 1.0 and 1.1. As part of the consideration, CUCI agreed to a "Rate Base Neutrality" covenant, which is contained in Section 5.3 of the Asset Exchange Agreement. Section 5.3 contains a formula for the valuation of the Bolingbrook water utility assets for rate-making purposes. The formula is as follows:

Citizens, therefore, agrees that it will only petition the Illinois Commerce Commission, in any rate case subsequent to Closing, to add the following maximum amount to its water rate base as a result of the asset exchange:

$$\begin{array}{c} \text{CUCI's Net Water Plant Rate Base} \\ \text{for all Illinois Customers} \\ \div \\ \text{The Total Number of CUCI's Illinois} \\ \text{Water Customers} \\ \times \\ \text{The Total Number of Water Customers} \\ \text{Residing in the Bolingbrook Service Area} \end{array}$$

EQUALS:

Maximum Rate Base Increase as a Result
of the Asset Exchange

See, Bolingbrook Exhibit 1.1 at pp. 21-22 of the Asset Exchange Agreement.

CUCI's Net Water Plant Rate Base for all Illinois Customers was established by the Commission in Docket No. 94-0481, decided September 13, 1995. The amount of CUCI's Net Water Plant Rate Base for all Illinois Customers was determined by the Commission to be \$28,236,543. *See*, Order in Docket No. 94-0481 at p. 6; Bolingbrook Exhibit 1.0 at pp. 3-4. The Asset Exchange Agreement was approved by Bolingbrook and CUCI the following year. CUCI

never initiated a subsequent rate-making proceeding before the Commission in which CUCI's Net Water Rate Base for all Illinois Customers was revalued or adjusted. Bolingbrook Exhibit R-1.0 p. 4; R.C. 100.

A.

The term "rate base" is commonly understood as the original cost value of utility property on which a return is allowed by the Commission. *See*, 220 ILCS 5/9-211 and 5/9-214(a)(2); *Peoples Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 25 N.E.2d 482 (1940); *Commonwealth Edison Company v. Illinois Commerce Commission*, 322 Ill.App.3d 846, 751 N.E.2d 196, 256 Ill.Dec. 143 (2001). Consequently, "CUCI's Net Water Plant Rate Base for all Illinois Customers," both at the time that the Asset Exchange Agreement was executed and at the time that the closing occurred, was set at \$28,236,543, which was the figure on which the Commission had allowed CUCI a return. In addition, the plain language of Section 5.3 only refers to "CUCI's" Net Water Plant Rate Base for all Illinois Customers, not to the rate base of any other entity, as admitted by IAWC's witness, Frederick Ruckman. R.C.102.

Despite the plain language of Section 5.3, IAWC claims that the term "CUCI's Net Water Plant Rate Base" should be interpreted to mean the "Chicago Metro District of Illinois-American Water Company's Net Water Plant Rate Base." As Ronald Stafford testified with respect to IAWC's interpretation and application of Section 5.3:

One provision of the agreement with the Village of Bolingbrook is that the Company will only petition the Commission to add, in rate cases subsequent to the asset exchange, an amount to rate base for the exchanged assets that is no greater than the average rate base per customer for all Chicago Metro Water District, multiplied by the number of customer residing in the Bolingbrook Service Area. Initially, rate base impact resulting from this asset exchange would exceed this formula, necessitating the adjustment. Over time, as the acquired assets are further depreciated, the rate base deduction will diminish and eventually

will be eliminated. This rate base deduction reflects the adjustment necessary to be in compliance with the agreement with the Village. [Emphasis supplied.]

IAWC Exhibit 4.0 at pp. 15-16. According to IAWC, if the Chicago Metro District Net Water Plant Rate Base (not CUCI's) is to be used in Section 5.3's formula, the rate base value to be used in the numerator of the formula is \$76,403,411. *See*, IAWC Exhibit 11.0 Schedule B-2.3 p. 1 of 1. Thus, there is a \$48 million difference between the figures used by Bolingbrook and IAWC in the first line of the formula's computation. The difference is attributable to Bolingbrook's use of CUCI's Net Water Plant Rate Base for All Illinois Customers, not the Chicago Metro District's Net Water Plant Rate Base for All Illinois Customers.

B.

While IAWC did purchase the assets of CUCI, including the Asset Exchange Agreement, there was never any agreement between Bolingbrook and IAWC to amend the language of Section 5.3's formula. The language has always read CUCI's Net Water Plant Rate Base for All Illinois Customers. It has never read Chicago Metro District of Illinois-American Water Company's Net Water Plant Rate Base for All Illinois Customers. Bolingbrook Exhibit 1.1; R.C. 100. Yet, according to Mr. Stafford's testimony, IAWC is seeking to have the Commission sanction a unilateral amendment to the Section 5.3 formula, one which was never agreed to by Bolingbrook.

The primary objective in contract construction is to give effect to the intention of the parties and that intention is to be ascertained from the language of the contract. *Omnitrus Merging Corp. v. Illinois Tool Works, Inc.*, 256 Ill.App.3d 31, 628 N.E.2d 1165, 195 Ill.Dec. 701 (1993). Where the language of the contract is plain and unambiguous, the contract cannot be rewritten to provide a better bargain to one of the parties. *Frederick v. Professional Truck Training School, Inc.*, 328

Ill.App.3d 472, 765 N.E.2d 1143, 262 Ill.Dec. 535 (2002); *Owens v. McDermott, Will & Emery*, 316 Ill.App.3d 340, 736 N.E.2d 145, 249 Ill.Dec. 303 (2002). Moreover, in this case, the Asset Exchange Agreement contains an integration clause which states:

Section 14.3. Amendments.

This Agreement shall not be modified or amended in any way except in writing approved by the parties hereto.

Bolingbrook Exhibit 1.1, Asset Exchange Agreement at p. 61. Where parties include an integration clause in their contract, the parties intend that the agreement be interpreted solely according to its own language. *Owens, supra*, 736 N.E.2d at 152; *see also, Air Safety, Inc. v. Teachers Realty Corp.*, 185 Ill.2d 457, 706 N.E.2d 882, 236 Ill.Dec. 8 (1999).

Based on the foregoing principles of contract interpretation, Bolingbrook submits that the Section 5.3 formula is unambiguous and must be enforced as written. CUCI's Net Water Plant Rate Base for All Illinois Customers was last determined by the Commission to be \$28,236,543 in Docket No. 94-0481. The Asset Exchange Agreement was never amended, as required by Section 14.3 thereof, to change the language of Section 5.3's formula to the "Chicago Metro District of Illinois-American Water Company's Net Water Plant Rate Base for All Illinois Customers." Absent such an agreed-to amendment, the Commission should reject IAWC's unilateral attempt to modify the formula and should enforce the formula as written.

C.

Should the Commission determine that, in the context of IAWC's acquisition of CUCI's assets, the term "CUCI's Net Water Plant Rate Base for All Illinois Customers" has been rendered

ambiguous, or susceptible of more than one meaning, then parole evidence may be considered.² As the Illinois Supreme Court held in *Martindell v. Lake Shore National Bank*, 15 Ill.2d 272, 154 N.E.2d 683, 689 (1958):

In general, the intention of the parties is to be determined from the final agreement executed by them, rather than from preliminary negotiations and agreements (*Clark v. Mallory*, 185 Ill. 227, 56 N.E. 1099) but previous agreements, negotiations and circumstances may be considered in determining the meaning of specific words and clauses. *Koelmel v. Kaelin*, 374 Ill. 204, 29 N.E.2d 106; 12 I.L.P., Contracts, § 215. Similarly, under well recognized exceptions to the parole evidence rule, extrinsic evidence is admissible to show the meaning of words used in a contract where there is an ambiguity, or when the language is susceptible of more than one meaning. *Adams v. Gordon*, 265 Ill. 87, 106 N.E. 517; *Evans v. Gerry*, 174 Ill. 595, 51 N.E. 615; *Hogan v. Wallace*, 166 Ill. 328, 46 N.E. 1136; Restatement of Contracts, sec. 238(a). [Emphasis supplied.]

Accord, Elliot v. LRSI Enterprises, Inc., 226 Ill.App.3d 724, 589 N.E.2d 1079, 168 Ill.Dec. 674 (1992). IAWC has argued that the term "CUCI's Net Water Plant Rate Base for All Illinois Customers" does not mean what it says. Should the Commission find that the term is susceptible of more than one meaning, then parole evidence is admissible to determine the meaning of this term as intended by the parties to the Asset Exchange Agreement. *Martindell, supra*. The only parties to the Asset Exchange Agreement were CUCI and Bolingbrook. IAWC was not a party to the Agreement. *See*, Bolingbrook Exhibit R-1.0 p.1.

The rebuttal testimony of Bolingbrook witness, Michael J. Drey, clearly explains the intent of CUCI and Bolingbrook with respect to the meaning of the term "CUCI's Net Water Plant Rate Base for All Illinois Customers." *See*, Bolingbrook Exhibit R-1.0 p.2-6. Mr. Drey cites to a business record of the transaction, i.e. a letter from CUCI's attorney which identifies significant

² IAWC has a standing objection to Bolingbrook's offer of parole evidence, which offer was made to demonstrate the intent of CUCI and Bolingbrook as the parties to the Asset Exchange Agreement. IAWC's Motion to Strike has been taken with the case.

issues being negotiated by the parties. On page 2 of that letter, CUCI's attorney explains the respective positions of the parties with respect to Rate Base Neutrality:

5. Water Rate Base Neutrality

Bolingbrook wishes to cap any increase in CUCI's water rate base relevant to the Asset Exchange to an amount equivalent to (x) the number of Bolingbrook water customers acquired by CUCI multiplied by (y) CUCI's current water rate base per customer.

CUCI is willing to cap any increase in its water rate base relevant to the Asset Exchange to an amount equivalent to (x) the reduction in CUCI's sewage rate base by reason of the conveyance of its sewage treatment assets to Bolingbrook, plus (y) the aggregate amount of all payments made by CUCI to Bolingbrook in relation to the Asset Exchange. [Emphasis supplied.]

See, Bolingbrook Exhibit R-1.0 at pp. 2-3; Bolingbrook Exhibit R-1.1. Bolingbrook's formulation was accepted by the parties and incorporated in Section 5.3. *See*, Bolingbrook Exhibit R-1.0 at p. 3.

In the event that the Commission determines that parole evidence should be admitted to clarify the intent of CUCI and Bolingbrook with respect to the formula, then the record is clear that the parties intended that CUCI's "current water rate base per customer" as it existed in 1996, was to be used. Under the *Martindell* rule, parole evidence is appropriate to determine the parties' intent with respect to specific words and clauses. Parole evidence also may be employed if there is an ambiguity or the words are susceptible of more than one meaning.

D.

In short, it is IAWC's position that the term "CUCI's Net Water Rate Base for all Illinois Customers" does not mean what it says. IAWC's argument must be rejected because the plain meaning of this phrase only refers to CUCI (not to any other entity) and because of the integration clause in the Asset Exchange Agreement. In addition, under the *Martindell* rule, the Commission

can consider parole evidence to determine the parties' intent with respect to specific words or clauses. Bolingbrook's uncontradicted evidence shows that CUCI and Bolingbrook's intent was that CUCI's "current" water rate base figure was to be utilized, as it existed at the time the Asset Exchange Agreement was executed.

Section 5.3 of the Asset Exchange Agreement limits the amount of rate base increase, with respect to the former Bolingbrook water utility assets, to the amount of \$6,462,132. *See*, Bolingbrook Exhibit 1.2. IAWC has proposed a rate base increase of \$12,655,000 for these assets. R.C. 93. Consequently, IAWC's request should be reduced by \$6,193,000 to \$6,462,132, which is the maximum amount allowable under Section 5.3 of the Asset Exchange Agreement.

III.

IAWC Has Failed to Meet its Burden of Proving Acquisition Savings

A second rate base-related issue concerns the methodology used in IAWC's Acquisition Savings proposal. In Docket No. 00-0476, the Commission approved the acquisition by IAWC of the water and wastewater assets of CUCI and certain business assets of a CUCI affiliate. In the course of that proceeding, IAWC argued that its acquisition of CUCI's assets would result in cost savings, which could then be shared by ratepayers and IAWC shareholders. Staff witness, Thomas Q. Smith, and other members of the Staff, had serious reservations about the ability of IAWC to demonstrate that savings were solely related to the acquisition of CUCI's assets. As Staff argued:

Staff states that savings cannot be shared if they cannot be identified. Staff indicates that Illinois-American identifies savings as the difference between the cost of operating Citizens as a part of the Illinois-American and the cost of operating Citizens as though it had not been acquired by Illinois-American. Therefore, Staff concludes that it would be necessary to develop a hypothetical cost of service for Citizens on a stand-alone basis in order to determine Acquisition savings. Staff states that it is Illinois-American's burden to develop the resources that will enable the Commission to identify this hypothetical cost of service.

Staff indicates that Illinois-American has not met its burden with conjecture that savings can be identified in year 1 and then adjusted as time progresses or by its promise to provide a detailed plan for identification of savings within five years. (Staff Initial Brief at 11)

* * *

Staff asserts that there is no way to verify hypothetical cost estimates for a stand-alone Citizens that will no longer exist. Staff states that engaging in such a fruitless endeavor could result in rates that are based on ad hoc cost estimates developed by Illinois-American to justify the recovery of the Acquisition revenue requirement. (*Id.* at 14)

Order in Docket No. 00-0476 at p. 25.

Nonetheless, the Commission determined that IAWC should be given the opportunity to prove that there were demonstrable Acquisition Savings.

The Order concluded that, in rate proceedings filed within three years of the date of the Order, savings resulting solely from the Acquisition should be shared between shareholders and customers on a 50/50 basis. The Order required that IAWC file, within 90 days of the date of the Order, a petition for approval of a specific methodology for quantifying the amount of Acquisition Savings. In accordance with the Order, on August 14, 2001, Illinois-American filed a petition in Docket No. 01-0556, seeking approval of a specific methodology for the purpose of quantifying the amount of Acquisition Savings.

The proposed methodology for quantification consisted of two components: (1) cost of Capital Savings and (2) Savings not related to Cost of Capital (the "two-part" methodology). Thomas Q. Smith reiterated his disagreement with including savings as a component of revenue requirement, but further recognized that the Commission had ordered that a Savings sharing program should be adopted. Order in Docket No. 01-0556 at p. 5. Mr. Smith agreed that the "two-part" methodology was reasonable, with the following qualification:

Mr. Smith recognized that, at this time, it is not possible to develop a template for calculating Savings based on specific inputs. According to Mr. Smith, a template cannot be developed until specific inputs are available at the time of a rate case. Mr. Smith indicated, however, that approval of the methodology would help limit the contested issues in a rate case. Mr. Smith stated his expectation that, at the time of the next rate case, Illinois-American will present all information that it believes necessary for the Commission to determine appropriate rate levels. Mr. Smith stated that, at that time, relevant information can be reviewed the evaluated, and an analysis can be provided for the Commission's consideration.

Order in Docket No. 01-0556 at p. 5.

The Commission approved the use of the "two-part" methodology. Pursuant to the Order, the amount of any Acquisition Savings would be allocated 50% to ratepayers and 50% to IAWC. Both IAWC and Staff have utilized a "two-part" methodology in this rate case. While Bolingbrook concurs with the Staff's application of the "two-part" methodology in most respects, Bolingbrook submits that the portion of the Acquisition Savings template related to labor cost savings is seriously flawed.³

In IAWC Exhibit 12.0 Schedule C-2.4 p. 1 of 1, IAWC presents its computation of the Acquisition Savings. The IAWC calculation identifies five categories of costs: (1) labor and labor-related expense; (2) management fees; (3) rate case expense; (4) non-Citizens rate area long term debt; and (5) Citizens rate area long term debt. IAWC's witness, Ronald D. Stafford describes IAWC's calculation methodology in IAWC Exhibit 4.0 pp. 24-28. Bolingbrook does not dispute that these categories are generally appropriate in order to quantify Acquisition Savings.

³Bolingbrook accepts the Staff's quantification of Cost of Capital Savings and of Savings Not Related to Cost of Capital, with one exception: labor and labor-related expenses. However, Bolingbrook further submits that any labor and labor-related expense increases should be used to offset other Savings as discussed below.

What Bolingbrook does dispute, however, is the manner in which the template was employed to quantify "labor and labor-related savings." IAWC claims "labor and labor-related savings" of \$821,136 with respect to the Chicago Metro Division.⁴ IAWC closed on the CUCI asset acquisition and took control of the Chicago Metro Division in January 2002. IAWC Exhibit 2.0 p. 5.

While IAWC claims that there have been significant labor-related savings as a result of the CUCI asset acquisition, labor expenses attributable to the Chicago Metro Division have ballooned by 34% since IAWC took over from CUCI in January 2002. According to IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8, the following is a summary of the changes in labor costs since the CUCI closing:

<u>Chicago Metro Division</u>	
December 31, 2001 (Historical)	December 31, 2003 (Pro forma)
\$ 1,556,358 (water)	\$ 2,666,642 (water)
<u>1,191,934</u> (sewer)	<u>1,025,842</u> (sewer)
\$ 2,748,292	\$ 3,692,484

See IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8.

IAWC has failed to adequately explain on this record how an increase in labor expenses of \$944,000 (or 34%) since IAWC assumed control over the Chicago Metro Division in January 2002 can somehow be categorized as labor expense "savings" of \$821,000.

Presumably, CUCI had adequate personnel immediately prior to the closing to provide safe and reliable public utility service. Indeed, in Docket No. 00-0476, the Commission specifically found: "There has been no showing that Citizens has been unable to provide safe and reliable service

⁴The Chicago Metro Division is comprised of Chicago Metro Water and Chicago Metro Sewer Districts.

or to raise necessary capital.” Order in Docket No. 00-0476, Section E., p. 39. If CUCI’s personnel were able to provide safe and reliable service to the Chicago Metro Division on December 31, 2001, IAWC’s proposed increase in labor-related expenses by \$944,000 from historical year 2001 to pro forma 2003 hardly seems to result in labor-related Acquisition Savings of \$821,000. In fact, it appears that instead of producing labor cost savings, IAWC’s acquisition of CUCI’s assets has actually caused these costs to jump by 34%, according to IAWC’s own testimony. Moreover, if the \$944,000 increase in labor-related expenses (IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8) is used to offset the reported savings in the categories of management fees, rate case expense and Citizens Rate Area long term debt (*see*, IAWC Exhibit 12.0 Schedule C-2.4 p. 1 of 1 at lines 2, 3 and 5), then the total amount of Acquisition Savings is actually a negative number.

In Docket No. 01-0556, the Commission approved the “two-part” Acquisition Savings methodology. However, the actual template for applying the methodology and its inputs were reserved for further review in the context of this rate proceeding. Bolingbrook submits that there is an obvious flaw in the labor cost portion of the template and its inputs if a labor cost increase of \$944,000 since IAWC assumed control can be somehow characterized as labor cost savings of \$821,000.

The burden of fully justifying that Acquisition Savings have in fact resulted from IAWC’s acquisition of CUCI’s assets lies with IAWC. As IAWC itself conceded in Docket No. 00-0476:

Illinois-American states that savings that result from a technological change will not be included in Acquisition savings and would not be used as a basis to allocate the Acquisition Revenue Requirement under the SSP. Illinois-American emphasizes that it has the burden in future rate cases to demonstrate that the savings under consideration initially result from, and continue to result from, the Acquisition. [Emphasis supplied.]

Order in Docket No. 00-0476, Section III.B.5 p. 23.

IAWC has failed to meet that burden in this case with respect to the labor cost component of the Acquisition Savings calculation. Far from demonstrating an overall decrease in labor costs since the CUCI asset acquisition, IAWC's testimony demonstrates precisely the opposite.

The Commission has proceeded in an extremely cautious manner in both Docket Nos. 00-0476 and 01-0556 in order to assure ratepayers that IAWC's shareholders will benefit only from Acquisition Savings that have, in fact, occurred and are solely attributable to the CUCI asset acquisition. The Commission has shown great concern that the ratepayers not be penalized by purported, but unjustified, Acquisition Savings. The labor cost component input clearly is flawed. CUCI provided safe and reliable service until December 31, 2001 at a total labor expense of \$2,748,292, yet safe and reliable service in pro forma 2003 would require IAWC to expend \$3,692,484. The record in this case simply does not support that any net Acquisition Savings have, in fact, been realized.

Bolingbrook, therefore, submits that IAWC has failed to meet its burden of demonstrating actual Acquisition Savings in this proceeding and that IAWC's request for Acquisition Savings with respect to the CUCI asset acquisition should be denied.

IV.

IAWC Cost of Capital

Bolingbrook accepts and adopts the Staff recommendation that IAWC's overall rate of return be set at 7.36%. Rebuttal Testimony of Sheena Kight, ICC Staff Exhibit 16.0, p.1.

V.

Chicago Metro Sewer Revenue Requirement

Chicago Metro Sewer Operating Revenue

Bolingbrook accepts the Staff's pro forma recommendation with respect to Chicago Metro Sewer Operating Revenues, including the \$800,857 adjustment shown on ICC Staff Exhibit 15.0 Schedule 15.4-CMS to Waste Disposal Revenues, except to the extent that Operating Revenues should be adjusted for the elimination of purported Acquisition Savings.

Chicago Metro Sewer Operating Expenses

Bolingbrook accepts the Staff's pro forma recommendation with respect to Chicago Metro Sewer Total Operating Expenses, as shown on Staff Exhibit 11.0 Schedule 11.1-CMS line 27.

Chicago Metro Net Operating Income

Bolingbrook accepts the Staff's pro forma recommendation with respect to Net Operating Income, Rate Base and Rate of Return for Chicago Metro Sewer; as shown on Staff Exhibit 11.0 Schedule 11.1-CMS lines 27, 28 and 29, except to the extent that there should be an adjustment for the elimination of purported Acquisition Savings for the reasons previously discussed.

The Staff pro forma Rate Base for Chicago Metro Sewer should, therefore, be reduced by \$119,644 to eliminate the Acquisition Savings component. *See*, Staff Exhibit 11.0 Schedule 11.3 CMS p. 1 of 1 line 9.

VI.

Chicago Metro Water Revenue Requirement

Bolingbrook has adopted the Chicago Metro Water revenue requirement, which was recommended by the Attorney General's witness, Scott Rubin. See, discussion at Section VII.C. below

However, regardless of which Chicago Metro Water revenue requirement proposal is ultimately adopted by the Commission, the revenue requirement must further be adjusted in order to account for the elimination of Acquisition Savings and the adjustment to the Bolingbrook water system acquisition rate base value, as discussed in Sections II and III, supra.

Chicago Metro Water Operating Expenses

Bolingbrook accepts the Staff's pro forma recommendation with respect to total Operating Expenses, as shown on Exhibit 11.0 Schedule 11.1 - CMW line 27, except to the extent that Staff's calculation of State and Federal Income Tax expenses may be affected by Bolingbrook's adjustments to Staff's pro forma Rate Base for Chicago Metro water.

In the event that Staff's rate design (rather than Mr. Rubin's) is adopted by the Commission, Bolingbrook strongly supports Staff's allocation of security-related expenses. Staff witness, Richard L. Jaehne presented a cogent and compelling rationale for the Staff's method of allocating security costs. No party presented any evidence which would serve to contradict Mr. Jaehne's conclusions with respect to the appropriateness of Staff's allocation methodology. See, In camera Transcript of the Testimony of Richard L. Jaehne, pp. 569-598.

In the absence of single tariff pricing, as proposed by Mr. Rubin, the Staff's allocation of operating expense is the only equitable method of allocating these costs.

Chicago Metro Water Net Operating Income

For the purposes of its pro forma Chicago Metro Water Rate Base, the Staff has accepted IAWC's figure of \$72,601,152. *See*, Staff Exhibit 11.0 Schedule 11.1 - CMW line 29. This rate base figure includes the amount of \$12,655,000, which IAWC, for rate-making purposes, has assigned as the value of the Bolingbrook water system assets purchased under the Asset Exchange Agreement. *See* R.C. 92-93; R.C. 338-40.

As previously stated, under Section 5.3 of the Asset Exchange Agreement between Bolingbrook and CUCI, there was a formula for the maximum amount of any rate base increase attributable to the acquisition of the Bolingbrook water system assets. As testified to by Michael J. Drey, the maximum increase in rate base under the formula is \$6,462,132. *See*, Bolingbrook Exhibit 1.2. For the reasons set forth in Section II, *supra*, Bolingbrook's computation should be used by the Commission. The effect would be to reduce the Staff's CMW rate base figure from \$72,601,152 to \$66,408,000.⁵ *Compare*, Staff Exhibit 11.0 Schedule 11.3 -CMW p. 1 of 1 line 24. With the reduction in rate base, there should be a corresponding reduction in pro forma Operating Revenue, State Income Tax Expense, Federal Income Tax Expense, and Net Operating Revenue.

In addition, Staff's pro forma rate base for Chicago Metro Water should be reduced in order to eliminate any purported Acquisition Savings for the reasons set forth in Section III, *supra*. With this adjustment, the amount of \$156,250 would also be eliminated from Staff's pro forma rate base. *See*, Staff Exhibit 11.0 Schedule 11.3 - CMW p. 1 of 1 line 9. Finally, Net Operating Income for

⁵(1) \$12,655,000 - \$6,462,000 = \$6,193,000

(2) \$72,601,000 - \$6,193,000 = \$66,408,000

Chicago Metro Water should be revised to mirror Mr. Rubin's rate design proposal for the reasons discussed in Section VII.C. below.

VII.

Other Intervenor Testimony

A. Lafayette Morgan

The Citizens Utility Board presented the testimony of Lafayette Morgan, a senior regulatory analyst with Exeter Association. With respect to the Chicago Metro District, the principal issue raised in Mr. Morgan's testimony relates to "Insurance Other than Group Expense." As Mr. Morgan has pointed out, IAWC is seeking to have the Commission approve the payment of "retrospective" insurance premiums. *See*, Direct Testimony of Lafayette Morgan at pp. 12-14 (Public Version). Bolingbrook agrees, for the reasons set forth in Mr. Morgan's testimony, that charging this expense to ratepayers represents a form of retroactive rate-making and that O & M expenses associated with this item should be reduced by \$429,684.

B. Michael Gorman

The Illinois Industrial Water Consumers presented the testimony of Michael Gorman with respect to certain IAWC proposed expenses and with respect to rate design. Bolingbrook agrees with Mr. Gorman's conclusion that IAWC's proposed pension expense has not been justified on this record. *See*, Rebuttal Testimony of Michael Gorman at pp. 16-18. IAWC's pension expense should, therefore, be reduced, as recommended by Mr. Gorman. Bolingbrook further agrees with Mr. Gorman's proposed adjustment to management fees which are allocated to IAWC. As Mr. Gorman has pointed out, IAWC's allocation methodology unfairly penalizes Illinois ratepayers due to the service company's loss of non-Illinois water districts. Rebuttal Testimony of Michael Gorman

at pp. 19-20. Moreover, IAWC has failed to demonstrate on this record that the service company's charges to IAWC are competitive with a third-party, non-affiliated service supplier. *Id.* at pp. 20-21. For these reasons, Mr. Gorman's adjustments to IAWC's pension expense and management fee expense should be adopted by the Commission.

Bolingbrook, however, disagrees with Mr. Gorman's approach to single tariff pricing. Under the Gorman approach, the Pekin District and the Chicago Metro District would be excluded from the benefits of single tariff pricing. *id.* at pp. 1-7. Mr. Gorman's approach is, in effect, a "selective" single tariff pricing proposal, which would only benefit certain Districts. If the Commission determines that single tariff pricing is appropriate for IAWC, there is no reasonable justification for excluding the Pekin District and the Chicago Metro District from the benefits of single tariff pricing simply on the basis of source of water. Rather, Mr. Scott Rubin's single tariff pricing proposal should be adopted by the Commission, as discussed below.

C. Scott Rubin

The People of the State of Illinois by the Office of the Attorney General presented the testimony of Mr. Scott Rubin. Mr. Rubin is an expert in the field of utility rate design. Mr. Rubin has advocated a single tariff pricing proposal for water services⁶ that would include all of IAWC's Districts. *See*, Rebuttal Testimony of Scott J. Rubin at pp. 22-25. Contrary to the claims of other witnesses, the source of water production (whether surface water, ground water or lake water) does not have a significant impact on Mr. Rubin's analysis and recommendations. *Id.*, pp. 23-25.

⁶Mr. Rubin's testimony does not address wastewater collection or wastewater treatment, which are also tariffed services provided by IAWC.

Mr. Rubin's rate design utilizes the Staff recommended revenue requirement for IAWC as a whole. *Id.* Schedule SJR-R5 p. 1 of 38. As shown on Schedule SJR-R5, Mr. Rubin's approach moderates the impact of IAWC's requested rate increase, particularly with respect to residential ratepayers. *Id.* Schedule SJR-R4 p. 1 of 1. Neither IAWC's, Mr. Gorman's nor the Staff's recommended rate design have taken into account the wide disparity in rate increases that ratepayers in the various Districts will experience under their proposals. Clearly, one of the important consequences of receiving service from a large utility, such as IAWC, should be that the percentage increase in rates is proportional over all similar rate blocks in each District. All ratepayers should share in meeting the utility's overall proposed revenue requirement when a rate increase is requested. Wide disparities in the percentage rate increase by District only serve to erode ratepayer confidence in the fairness of the rate structure approved by the Commission. *Id.*, pp. 16-18. Mr. Rubin is the only witness in this case who actually performed a customer impact analysis. *Id.*, pp. 25-26. Other witnesses simply ignored the problem. In addition to avoiding wild swings in rate increases among the various Districts, Mr. Rubin's proposal has other obvious benefits as well. As Mr. Rubin has stated:

Moreover, moving toward single tariff pricing should enable the company to realize efficiencies and economies of scale that can then be passed along to customers in the form of lower rates. The ability to spread investment costs over a larger customer base will create incentives for IAWC to make those investments more economically, as they become necessary, instead of having to delay prudent investments in order to avoid the rate shock that might result if the costs were borne only by individual water districts. As the Company consolidates rate areas and further simplifies its tariffs, single tariff pricing also should reduce the complexity and expense of IAWC rate cases.

Id., pp. 27-28

For these reasons, Bolingbrook strongly supports Mr. Rubin's rate design for IAWC's water rate tariffs and urges that it be adopted by the Commission.

If the Commission decides, however, not to utilize Mr. Rubin's rate design, then the Staff rate design should be adopted in this proceeding since it more equitably allocates District-specific costs than does IAWC's proposed rate structure.

D. Raymond Schmitt/Elizabeth Davis

The testimony of the Mayor of the City of Streator graphically illustrates the "rate shock" and erosion in ratepayer confidence that will occur unless Mr. Rubin's rate design is accepted by the Commission. Mr. Schmitt's testimony confirms the point that wide disparities in the percentage rate increases among the various Districts simply do not appear equitable to ratepayers. *See, Rebuttal Testimony of Raymond Schmitt.* Each District compares its rate increase percentage with that of the other Districts. The Mayor of the City of Lincoln, Elizabeth Davis, draws similar comparisons. *See, Rebuttal Testimony of Elizabeth Davis.* The Mayors' testimony serves to confirm that Mr. Rubin's rate design should be utilized by the Commission in order to mitigate any perceived unfairness to any particular District.

E. O'Fallon Testimony

Since the City of O'Fallon has reached a provisional agreement with IAWC as to its wholesale rate, Bolingbrook has no comment with respect to O'Fallon's testimony in this case.

Conclusion

For the foregoing reasons, Bolingbrook respectfully submits that the Commission's order in this proceeding should reflect the Staff's basic position except for the additional adjustments advocated by Bolingbrook and except for the Attorney General's recommended rate structure.

Respectfully submitted,



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